Supreme Court, U.S.
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In The
Supreme Court of the United States

FORD T. JOHNSON, JR.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Petition for Writ of Certiorari

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QUESTION PRESENTED

Shall the determination of whether a corporate officer acted willfully and is thus liable under 26 U.S.C. § 6672 for a corporation's unpaid withholding taxes be made by a jury that considers all relevant evidence as to the officer's actual intent or be made without a jury as a matter of strict liability on the basis of those circumstances identified in prior caselaw as conclusive rather than on the basis of actual intent?

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Ford T. Johnson, Jr. ("Johnson"), respectfully prays for a writ of certiorari to review the final decision and judgment of the United States Court of Appeals for the Fourth Circuit affirming the judgment of the United States District Court for the District of Maryland, which entered summary judgment against Petitioner.

OPINIONS BELOW

The opinion and judgment of the United States Court of Appeals for the Fourth Circuit was filed on November 6, 2002 (App. 1-2). The opinion is reported in the Federal Appendix at 50 Fed. Appx. 113. A petition for rehearing en banc was filed on December 23, 2002, and denied by Order of the Court dated January 28, 2003 (App. 26).

The memorandum opinion of the United States District Court for the District of Maryland granting summary judgment against Petitioner was filed on January 15, 2002 (App. 5-25). The memorandum opinion is reported at 203 F. Supp. 2d 416 (D. Md. 2002). The judgment of the District Court against Petitioner was entered on January 28, 2002 (App. 3-4).

JURISDICTION

The opinion and decision of the United States Court of Appeals for the Fourth Circuit was filed on November 6, 2002 (App. 1-2). A petition for rehearing en banc was filed on December 23, 2002, and denied by Order of the Court dated January 28, 2003 (App. 26). Jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (2001).

STATUTORY PROVISIONS INVOLVED

The statutory provisions involved in this case are set forth in the Appendix beginning at page App. 27.

26 U.S.C. § 3102(a) (2001)

26 U.S.C. § 3402(a) (2001)

26 U.S.C. § 6672(a) (2001)

26 U.S.C. § 7501(a) (2001)

28 U.S.C. § 1254 (2001)

28 U.S.C. § 1291 (2001)

28 U.S.C. § 1346(a)(1) (2001)

28 U.S.C. § 2402 (2001)

STATEMENT OF THE CASE

The Factual Background

The District Court entered judgment against Petitioner Johnson personally for the amount due to the Internal Revenue Service ("IRS") from Koba Associates ("Koba") (a corporation) for its employees' withholding taxes for the third and fourth quarters of 1994 and the first quarter of 1995. Koba was an entirely minority owned business located in the District of Columbia, and Johnson was the president and sole owner of the voting shares of that corporation. The primary business of Koba was the performance of government contracts with the District of Columbia and federal governments for human services. Like many other government contractors in the District of

Columbia, Koba encountered financial difficulties in 1994 when the District of Columbia government became delinquent in paying its bills. This financial problem was compounded when the federal government also became delinquent in paying what it owed Koba.

In the second quarter of 1994, Johnson hired Laurence Morrison ("Morrison") as the Chief Financial Officer of Koba at a salary exceeding that which Koba had ever paid anyone in that position. In light of the large salary that Johnson was paying Morrison and the substantial experience that Morrison had prior to joining Koba, Johnson delegated to Morrison all responsibility for the financial operations of Koba. This included the determination of what bills were to be paid. Johnson's intent making this delegation was to enable himself to spend his time on marketing activities and obtaining new contracts for Koba as well as ensuring that all existing contracts were performed in accordance with the requirements of those contracts.

In October of 1994, Johnson became aware that the withholding taxes that Koba owed the IRS for the then completed third quarter had not been paid. As a result he arranged a payment plan with the IRS for the delinquent taxes and for a period of time monitored Morrison's actions to insure that Morrison was paying the withholding taxes as Johnson had instructed.

In January, 1995, Morrison and Sandra Robinson (who was the general counsel for Koba) told Johnson that the IRS planned to levy. Johnson then negotiated an agreement with IRS that same month to prevent the levy, and Koba was subsequently making the payments that IRS had agreed to accept under the agreement. Johnson also directed Sandra Robinson to monitor the payment of taxes by Koba under that agreement.

The IRS and Koba concluded a revised payment plan in July, 1995, and Koba complied with the terms of that plan until it filed a petition under Chapter 11 of the Bankruptcy Code in February, 1996. The bankruptcy was later converted to one under Chapter 7 of the Bankruptcy Code, and Koba was then liquidated. In 1997, the IRS denied Johnson's claim for a refund of overpaid income taxes in the amount of $15,435.50 on the ground that it had applied that amount to a civil penalty under 26 U.S.C. § 6672(a) (2001) assessed against Johnson because of Koba's failure to pay the payroll taxes.

Proceedings Below

In September, 1998, Johnson filed a civil action against the United States in the United States District Court for the District of Maryland seeking a refund from the United States of the $15,435.50 that IRS had refused to refund to him. The district court had subject matter jurisdiction of this action under 28 U.S.C. § 1346(a)(1) (2001). The United States answered and filed a counterclaim in the amount of $1,163,200.29 for the balance of the penalty assessed against Johnson under § 6672(a) plus interest and penalty. In September, 2001, the United States filed a motion for summary judgment on Johnson's claim as well as for recovery of the full amount of its counterclaim, and Johnson subsequently filed an opposition. By memorandum opinion dated January 15, 2002, the district court granted the motion of the United States for summary judgment (App. 5-25). It found as a matter of law that Johnson had acted willfully within the meaning of § 6672(a) in failing to insure that Koba paid its withholding taxes. In an order entered January 28, 2002, the district court entered judgment in the amount of $$1,498,004.01 against Johnson (App. 3-4).

Johnson subsequently filed a timely appeal on February 27, 2002 to the United States Court of Appeals for the Fourth Circuit. The Court of Appeals had jurisdiction of that appeal under 28 U.S.C. § 1291 (2001). On November 6, 2002, The Court of Appeals affirmed the decision of the District Court (App. 1-2), and on January 28, 2003, it denied Johnson's petition for rehearing en banc (App. 26).

REASONS FOR GRANTING THE WRIT

The federal courts of appeals have reached inconsistent results as to the evidence which suffices to create a jury question on the issue of whether a corporate officer is liable under 26 U.S.C. § 6672(a) for the amount of a corporation's payroll taxes because the officer has acted willfully in failing to insure that the corporation has paid those taxes. The interpretation that some courts have placed on the term "willfully" in § 6672(a) equates that term with strict liability without regard to actual intent and ignores this Court's teaching that courts must treat the plain language of a statute as conclusive, see Consumer Products Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980), and not impermissibly rewrite a statute through construction, see Commissioner of Internal Revenue v. Lundy, 516 U.S. 235, 254 (1996) (quoting Badaracco v. Commissioner of Internal Revenue, 464 U.S. 386, 398 (1984)). The failure of some circuits, including that of the Court of Appeals in the instant case, to examine all evidence of actual intent has led to the almost universal denial in those circuits of the statutorily guaranteed right to a jury trial in tax refund cases. See 28 U.S.C. § 2402 (2001)

This Court in United States v. Energy Resources Co., 495 U.S. 545 (1990) set forth the basic law on the subject of responsible person liability. The Court noted that sections 3102(a) and 3402(a) of the Internal Revenue Code [26 U.S.C. §§ 3102(a) and 3402(a) (2001)] require employers to withhold

from their employees' paychecks money representing the employees' personal income taxes and social security taxes. 495 U.S. at 546. Because § 7501(a) of the Internal Revenue Code [26 U.S.C. § 7501(a) (2001)] requires employers to hold these funds in "trust for the United States", these taxes are commonly known as "trust fund" taxes. 495 U.S. at 546-47.[1] A corporate officer or employee may be personally liable for these trust fund taxes under the conditions provided in 26 U.S.C. § 6672(a) for personal liability, and an individual who has such liability is referred to as a "responsible" individual. 495 U.S. at 547.

The District Court in the instant case identified the two established elements for finding responsible person liability under § 6672(a) on the part of a corporate officer for the corporation's unpaid withholding taxes. First, the individual must be a responsible person, i.e. one "required to collect, truthfully account for and pay over the tax". 203 F. Supp. 2d 416 (quoting O'Connor v. United States, 956 F.2d 48, 50 (4th Cir. 1992)). Second, this individual "must have willfully failed to insure that the withholding taxes were paid." 203 F. Supp. 2d 416 (quoting O'Connor v. United States, 956 F.2d at 50). The second element, that the corporate officer act "willfully", is both what is at issue in the instant case and what has divided the courts of appeals that have confronted the issue of when a corporate officer acts with that intent.

The different approaches to the question of when an officer acts willfully are set forth in the discussion by the en banc court in Finley v. United States, 123 F.3d 1342 (10th Cir. 1997). The court in Finley noted

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[1] Conversely, those taxes that an employer owes but that are not deducted from an employee's wages are known as "non-trust fund" taxes. In re Technical Knockout Graphics, Inc., 833 F.2d 797, 799 (9th Cir. 1987).

> We are fully aware of the precedent whereby courts have seized on the notion that certain factual paradigms establish willfulness as a matter of law, even though the facts do not involve an intentional failure to pay over withholding taxes to the government. A responsible person's failure to investigate the problem or correct mismanagement after receiving notice of a withholding tax delinquency represents the factual paradigm applied in this case. Reliance upon the representation of someone in control of company finances that withholding taxes will be paid after learning that such taxes are delinquent, and when it is known that the person making the statements is unreliable and has inadequately performed his financial responsibilities in the past, represents another paradigm used to impose liability under § 6672 as a matter of law. The payment of other bills with knowledge that the business is in financial trouble, but failing to reasonably inquire whether money would be available to pay withholding taxes when they became due is yet another paradigm courts have applied.

Id. at 1346 (10th Cir. 1997). Under this "factual paradigm" approach, these factual circumstances (as stated by the court in Finley) conclusively establish willfulness as a matter of law even if the corporate officer could present "convincing evidence of extenuating circumstances relevant to his state of mind." Id. at 1347.

This "factual paradigm" approach was what the Court of Appeals applied in the instant case. In a two paragraph opinion, the Court of Appeals affirmed the

judgment of the District Court on the basis of the reasoning of the District Court.[2] The District Court in the instant case found Johnson liable under the factual paradigm that a corporate officer acts willfully as a matter of law when the officer fails to adequately supervise an unreliable subordinate. 203 F. Supp. 2d at 423-425. The decisions of the Court of Appeals and the District Court in the instant case reflect what the court in Finley described as "the rigid application of the 'failure to investigate or correct mismanagement' paradigm to impose liability as a matter of law." 123 F.3d at 1347.

The court in Finley declined to follow the approach of those courts that have applied the factual paradigms to impose liability as a matter of law without regard to evidence of actual intent. The Finley court instead decided that it would "continue to apply the established paradigms to identify willful conduct as a matter of law", but would "expressly recognize a reasonable cause exception to the application of those paradigms." 123 F.2d at 1348. Under the reasonable cause approach adopted by the court, a corporate officer can rebut the inference of willfulness arising from application of one of the factual paradigms if the officer can make a two part showing: first, that he has made "reasonable efforts to protect the trust funds"; and second, that "those efforts have been frustrated by circumstances outside the taxpayer's control". Id. at 1348. The court noted that this approach allowed determination of whether the officer had acted with the relevant intent "based upon *all* relevant evidence in a particular case". Id. The Second Circuit has also recognized that a showing of

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[2] While the Court of Appeals stated that it had "reviewed the record, including the district court's opinion, as well as the parties' briefs", it nonetheless cited the District Court's opinion by the docket number of the District Court case even though the appellant Johnson in his reply brief had provided the court with the Federal Supplement citation to the District Court's opinion.

reasonable cause can prevent a finding of willfulness. See Winter v. United States, 196 F.3d 339, 345 (2d Cir. 1999).

The court in Finley remanded the case to allow an opportunity for the officer to prove - and for the jury to determine - whether the officer had reasonable cause for his failure to make payment of the withholding taxes. 123 F.3d at 1349. So also in the instant case Johnson must have the opportunity to have a determination of his case by a jury under the "reasonable cause" standard articulated by the court in Finley and to have consideration of all evidence as to his intent. It is undisputed that Johnson took some steps at bar to insure that the withholding taxes were paid: he negotiated payment plans with the IRS; he did supervise Morrison until he was satisfied that Morrison would perform his duties; and then he appointed his in-house counsel to supervise Morrison. Whether these steps establish the necessary reasonable cause in the face of various government entities to satisfy their obligations is a decision that the jury must make.

The court in Finley explained the reasons for its adoption of the reasonable cause standard. The first reason is the explicit language of § 6672. The second is the necessity for preserving the role of the jury.

The court in Finley observed that the plain meaning of the statutory term "willfully" required consideration of "the state of the responsible person's mind". 123 F.3d at 1347. This Court in Slodov v. United States previously noted that § 6672 "cannot be construed to impose liability without fault". 436 U.S. 238, 254 (1978). The court in Finley noted that to determine willfulness without an evaluation of the "conscious motions supporting a responsible person's conduct would be to deprive the word 'willfully' of its operative effect." 123 F.3d at 1347. The Finley court further stated that those courts that find liability under § 6672 solely

on the basis of the paradigms and without consideration of any other factors providing reasonable cause for the failure to pay "have transformed 26 U.S.C. § 6672 into a strict liability statute". 123 F.3d at 1346. The lack of fidelity to the statutory language by those courts applying solely the factual paradigms is illustrated by the statement of one court that a corporate officer was liable under § 6672 for "'unwittingly' willful" action - even though that term on its face is an oxymoron. Buffalow v. United States, 109 F.3d 570, 573 (9th Cir. 1997).

The other reason that the court in Finley allowed a showing of reasonable cause to defeat the inference of willfulness from the factual paradigms is the necessity of preserving the jury function of fact-finding. The Finley court reasoned that the term "willfully" presented the "quintessential jury issue" of scienter. 123 F.3d at 1347 (quoting Turpin v. United States, 970 F.2d 1344, 1350 (4th Cir. 1992)). The court in Finley concluded that through use of this term in the statute, "Congress must have contemplated that in most cases a jury would be permitted to determine whether a responsible person failed to pay withholding taxes based on the totality of circumstances and evidence." 123 F.3d at 1347. Those courts that make a determination as to the corporate officer's intent solely on the basis of the factual paradigms and without consideration of any other evidence have "impermissibly encroached upon the role of the jury as fact-finder". Id.

The court in Finley acknowledged that the adoption of the factual paradigm approach lessened the government's burden of establishing liability under § 6672(a). 123 F.3d at 1345. That approach, however, reflects a construction of the statute at odds with the plain meaning of the statutory language. More importantly, the adoption of the factual paradigms approach, to the exclusion of other evidence of intent, has resulted in the almost universal denial of a jury

to those who seek to have a neutral determination of whether the IRS has properly assessed a penalty under § 6672(a). Accordingly review by this Court is necessary to insure that the jury's fact-finding function is preserved.

CONCLUSION

For the foregoing reasons this Court should grant the Petition for Writ of Certiorari, vacate the judgment of the United States Court of Appeals for the Fourth Circuit, and remand the case for further proceedings not inconsistent with the Court's opinion.

Respectfully submitted,

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UNPUBLISHED
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

FORD T. JOHNSON, JR.,
Plaintiff-Appellant,

v. No. 02-1240

UNITED STATES OF AMERICA,
Defendant-Appellee.

Appeal from the United States District Court
for the District of Maryland, at Baltimore.
Frederic N. Smalkin, Chief District Judge.
(CA-98-3050-S)

Submitted: October 17, 2002
Decided: November 6, 2002
Entered: November 6, 2002

Before WILLIAMS and TRAXLER, Circuit Judges, and HAMILTON, Senior Circuit Judge.

Affirmed by unpublished per curiam opinion.

COUNSEL

Ernest P. Francis, ERNEST P. FRANCIS, LTD., Arlington, Virginia, for Appellant. Eileen J. O'Connor, Assistant Attorney General, Kenneth L. Greene, Karen D. Utiger, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellee.

Unpublished opinions are not binding precedent in this circuit. See Local Rule 36(c).

OPINION

PER CURIAM:

Ford T. Johnson, Jr., appeals from the district court's order granting summary judgment to the United States on Johnson's claim for refund of the 100% penalty assessed against him under 26 U.S.C. § 6672 (2000), and the United States' counterclaim for the remainder of the penalty, for the third and fourth quarters of 1994 and the first quarter of 1995. We have reviewed the record, including the district court's opinion, as well as the parties' briefs and find no reversible error. The evidence before the district court established that Johnson "willfully" failed to pay over the payroll taxes at issue, within the meaning of § 6672. *See Plett v. United States*, 185 F.3d 216 (4th Cir. 1999). To the extent that Johnson challenges the government's alleged attempts to double-collect the unpaid taxes at issue, the district court's opinion clearly states that "no double recovery . . . shall be permitted."

Accordingly, we affirm on the reasoning of the district court. *See Johnson v. United States*, No. CA-98-3050-S (D. Md. Jan. 29, 2002). We dispense with oral argument because the facts and legal contentions are adequately presented in the materials before the court and argument would not aid the decisional process.

AFFIRMED

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

FORD T. JOHNSON, JR.,

v.

UNITED STATES OF AMERICA

CIVIL NO. S-98-3050

Entered: January 28, 2002

For the reasons stated in the Memorandum Opinion issued on January 15, 2002, it is this 28th day of January, 2002, ORDERED:

1. That the Defendant's Motion for Summary Judgment BE, and it hereby IS, GRANTED;

2. That judgment BE and it hereby IS, ENTERED in favor of the Defendant in the amount of $1,498,004.01, plus interest at the statutory rate (and statutory penalties, if any), accruing after the date hereof;

3. That the Defendant's recovery, whether it be pursuant to this judgment or to its rights as a creditor in bankruptcy of Koba Associates, Inc., shall be a full and final satisfaction *pro rata* of the debt owed to the United States by virtue of Koba Associates, Inc.'s, failure to pay employee withholding taxes, and no double recovery, as described in the said Memorandum shall be permitted;

4. That each party bear its own costs;

5. That this case BE, and it hereby IS, CLOSED; and

6. That the Clerk of the Court mail copies hereof to counsel for the parties

/s/Frederic N. Smalkin
Frederic N. Smalkin
Chief United States District Judge

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203 F.Supp.2d 416
89 A.F.T.R.2d 2002-1000, 2002-1 USTC P 50,267
(Cite as: 203 F.Supp.2d 416)

United States District Court,
D. Maryland.

Ford T. JOHNSON, Jr.,

v.

UNITED STATES of America

No. S-98-3050.

Entered: Jan. 15, 2002.

Corporation's president, who had been assessed for failure to pay over withholding taxes, sued for refund, and government counterclaimed for unpaid balance. On government's motion for summary judgment, the District Court, Smalkin, Chief Judge, held that: (1) president was "responsible person," and (2) his failure to ensure corporation's payment of taxes was "willful."

Motion granted.

West Headnotes

[1] Internal Revenue k5205
220k5205

Corporation's president was "responsible person," for purpose of determining his personal responsibility for unpaid employee withholding taxes; president had decision-making authority over company's finances, was

actively involved in day-to-day management, personally negotiated payment plans with Internal Revenue Service (IRS), and personally directed or directed others to supervise subordinate's compliance with payment plans. 26 U.S.C.A. § 6672.

[2] Internal Revenue k5205
220k5205

More than one person within corporation can be "responsible person," and thus be held personally responsible for unpaid employee withholding taxes. 26 U.S.C.A. § 6672.

[3] Internal Revenue k5219.25
220k5219.25

President's failure to ensure corporation's payment of employee withholding taxes was "willful," for purpose of determining his personal responsibility; president was aware of payroll tax deficiencies, but failed to adequately supervise subordinate's handling of problem. 26 U.S.C.A. § 6672.

[4] Bankruptcy k2830
51k2830

[4] Internal Revenue k5225
220k5225

Government's filing of claim in corporation's bankruptcy proceeding for unpaid employee withholding taxes did not preclude its claim to recover those taxes from responsible person; concerns that government would attempt to obtain double recovery were unfounded, and could be addressed by court if they occurred. 26 U.S.C.A. § 6672. ***417** Ernest P. Francis, Law Office, Arlington, VA, for Ford T. Johnson, Jr., plaintiffs.

Gerald Alan Role, U.S. Department of Justice G/A, Melissa Anemojanis Holton, U.S. Dept. of Justice, Washington, DC, for USA, defendants.

MEMORANDUM OPINION

SMALKIN, Chief Judge.

This case arises out of a tax dispute between the Internal Revenue Service and the plaintiff, Ford T. Johnson, who was, at all relevant times, the president, chairman of the board, and majority shareholder of Koba Associates, Inc. (Koba). Koba was a small company engaged in, among other things, community planning and economic development in the District of Columbia. In 1997, the IRS withheld $15,435.50 from Johnson's 1995 personal tax return, and Johnson brought this action to recover that amount. The IRS counterclaims that the plaintiff is liable for $887,726.78 (plus interest and statutory penalties) in Koba's unpaid employee withholding taxes from the last two quarters of 1994 and the first quarter of 1995. The IRS contends that the plaintiff is responsible for 100% of the unpaid taxes because he was a "responsible person," who willfully failed to pay employee withholding taxes for the three quarters indicated above. *See* 26 U.S.C. § 6672 (2001).

Johnson seemingly does not challenge the IRS's claim that he is a "responsible person" under section 6672, but he does contend that his conduct was not willful. Johnson argues that, prior to the three quarters in question, he hired Laurence Morrison, a highly qualified and experienced financial officer, to assume complete responsibility for Koba's financial affairs. When Johnson discovered that Koba was behind on its withholding taxes, he personally arranged a plan with the IRS to satisfy the company's tax liability. Johnson contends that he carefully instructed Morrison to comply with this plan and that he monitored

Morrison's activities to varying degrees during the three periods in question. He also argues that, to his knowledge, Morrison was handling the company's tax liability in accordance with the IRS's wishes. Johnson also asserts that he was unaware of any non-compliance because: (1) Morrison was a highly qualified vice president of finance on whom he ***418** could rely; (2) he was satisfied that Morrison knew of the importance of paying withholding taxes; (3) he had monitored Morrison's successful compliance with the plan at times; (4) whenever he met with Morrison to discuss the financial status of the company, Morrison never mentioned any further problems with the IRS; and (5) upon hiring Morrison, Johnson surrendered all control of Koba's accounting matters, and instead focused on marketing activities, obtaining new contracts, and supervising existing contracts.

Johnson also contends that, if found liable, the amount owing should be reduced in light of the IRS's rights as a creditor in Koba's bankruptcy proceedings, and the federal government's refusal to pay monies owed on contracts with Koba.

I. *FACTUAL BACKGROUND*

Johnson founded Koba Associates in 1968. Shortly thereafter, he incorporated the company, acting as its sole officer, shareholder, and chairman of the board. Koba grew under Johnson's direction, and, by 1994, it had between 130 and 150 employees. Johnson was regularly involved in, and was responsible for, the day-to-day management and operation of the corporation. He made major hiring and firing decisions, and he employed and met weekly with a handful of vice presidents, all of whom reported directly to him. Johnson also managed Koba's finances and, until 1994, determined which creditors were paid and when.

It was not uncommon for Koba to be behind on its withholding taxes, even under Johnson's personal direction. Johnson explained, however, that he always managed to avoid serious action by the IRS:

> "Being behind on taxes is not an unusual thing for a small company.... It happens all the time.... And you learn to live with it, and the IRS for the most part works with companies. They don't give you a lot of rope, but they want to see you make it too, and if you're reasonable and you keep your records -- we had a history of 26, 27 years of being behind, but we always managed to get the quarterly payments made.
>
> I was always able to juggle it. When I was in charge, it never didn't get paid, and I did that for 20 some years, so having-being behind in taxes or having penalties due was not an unusual thing. It was something that was quite standard, but we always were able to work a strategy out, get it paid, juggle with the vendors to get it done."
>
> Johnson Depo. at 37-38.

Much of Koba's business consisted of community planning and development contracts with the District of Columbia. In the early 1990s, Koba's financial affairs were in jeopardy, in part because of its inability to collect monies owed under government and other contracts. Johnson had become increasingly involved with managing Koba's finances. In May 1994, Johnson hired Laurence Morrison, a highly qualified and experienced financial manager, as director of finance so that Johnson could focus entirely on other affairs.

A. *The Third Quarter of 1994 (July--September)*

In the several weeks after Morrison was hired--into the third quarter of 1994--Johnson instructed Morrison on how to handle the company's finances. He explained to Morrison how to manage accounts payable and receivable by delaying some creditors while paying others, and how to keep current on employee withholding taxes. During this initial stage of Morrison's employment, Johnson closely supervised his work and met with him on a regular basis to discuss the financial posture of the corporation. Eventually, according ***419** to Johnson, he promoted Morrison to vice president and surrendered full control of the financial department to Morrison. Within a few months, it appeared to Johnson that Morrison had finally balanced out Koba's financial affairs. Morrison ostensibly was satisfying creditors while still keeping Koba's finances afloat. Johnson assumed that this was because of Morrison's exceptional talent at collecting outstanding accounts receivable.

Johnson met with Morrison every Monday. Morrison regularly provided Johnson with an accounts payable list showing all of the corporation's creditors, as well as an accounting of the checks that had been written on corporate accounts. In October of 1994, Johnson reviewed and signed the corporate quarterly tax return for the third quarter of 1994, which he discussed with Morrison. On its face, the form indicated that Koba had unpaid withholding taxes due and owing in the amount of $415,853.82, and that no payments had been made by the corporation during the quarter.

B. *The Fourth Quarter of 1994 (October--December)*

According to Johnson, by the fourth quarter of 1994, Morrison had assumed full responsibility for Koba's finances; he was deciding independently which creditors to

pay and which checks to write and was meeting independently with Koba's other vice presidents. In October 1994, the IRS notified Johnson that Koba was delinquent on its withholding taxes for the preceding period. Johnson immediately contacted the IRS. He explained on deposition that he understood the seriousness of cooperating with the government:

> I wrote a letter to the IRS back in October ... basically giving them a pay out schedule [hereinafter "the October Plan"], and I met with [Morrison] at that time and said, Here is what I have given my word on, you must now meet this, do not play with it because once you write a letter to the IRS and you tell them that this is what you're going to do, you better darn well do it or they will step in and they will issue a levy on you.
>
> Johnson Depo. at 40.

Johnson also acknowledged his primary role in insuring that Koba met the plan's requirements:

> I wrote the letter. I met with [Morrison]. I told him about the absolute importance of this. Not only had I given my name, but they would not play around at this point.
>
> *Id.*

Johnson met with Morrison to make certain that he would abide by the agreement. Johnson then took a more direct role in supervising Morrison's activities. After he became satisfied that Morrison was meeting the requirements of the plan, he "backed off" and again relinquished control of the company's finances. Throughout

the fourth quarter of 1994, Morrison provided Johnson with written summaries of Koba's financial status. According to Johnson, none of these reports mentioned any further problems with Koba's compliance with the October Plan or with its continuing obligation to pay withholding taxes for the fourth quarter. Moreover, Johnson claims that Morrison assured him that he was following the October Plan, and Johnson assumed this to be true. He explained that Morrison would have come to him if there were a major problem, and that he had "insisted enough" that Morrison abide by the October Plan.

In December, either Morrison or Sandra Robinson, the company's in-house counsel, received from the IRS a notice of intent to levy. The IRS took such action because of Koba's continued failure to pay employee ***420** withholding taxes during the fourth quarter of 1994 and its failure to comply with the October Plan. Johnson reviewed and signed Koba's quarterly tax return for the fourth quarter of 1994, which, on its face, indicated that Koba had unpaid payroll taxes due and owing for that quarter in the amount of $324,655.65.

C. *The First Quarter of 1995 (January--March)*

In January 1995, Robinson and Morrison notified Johnson of the IRS's intent to levy. Johnson again became "directly involved" in Koba's tax situation, engaging in "a whole flurry of meetings with the IRS to try to get them to back off issuing the levy." Johnson Depo. at 63. Johnson then set up yet another payment plan with the IRS. He appointed Robinson to monitor Morrison "to mak[e] absolutely certain that Morrison kept the commitment we made in January." The corporation, however, was unable to meet its tax obligations during the first quarter of 1995 as well. Again, Johnson reviewed and signed Koba's corporate

tax returns for the first quarter of 1995, which clearly indicated the extent of Koba's growing, unpaid tax liability.

During each of the three quarters described above, Koba, under the direction of Johnson and Morrison, continued to pay creditors other than the IRS. Johnson Depo. at 50-51.

D. *The Present Suit*

In 1995, Johnson overpaid his personal income taxes in the amount of $18,590 and filed a complaint in this Court, alleging that the IRS, after applying $3,154.50 of the overpayment to satisfy a tax debt owed by the plaintiff from 1993, wrongfully applied the remaining $15,435.50 to the withholding taxes owed by Koba. The United States filed a counterclaim, seeking judgment on the plaintiff's liability for the withholding taxes still unpaid.

The IRS contends that, as a matter of law, the plaintiff was a responsible person within the meaning of 26 U.S.C. § 6672 (2001). Moreover, the Government claims that the plaintiff's conduct in the last two quarters of 1994 and the first quarter of 1995 amounted to willful failure to pay withholding taxes. Primarily, the Government contends that the plaintiff had actual knowledge of, and control over, Koba's finances, and that he knew of the tax deficiency but recklessly failed to insure that the United States was paid before other creditors. As evidence of willfulness, the Government points out that Johnson received actual notice of the deficiency, initiated further contact with the IRS, set up payment plans, supervised Morrison's compliance with the plans (either personally or through in-house counsel), and, at the end of each quarter, signed corporate tax returns which indicated that Koba had not paid its withholding taxes.

The plaintiff, however, argues that there is a genuine controversy as to whether his conduct amounted to "willfulness" as required under section 6672. The plaintiff argues that a reasonable jury could conclude that his complete delegation of financial responsibility to Morrison in July of 1994, and his belief that Morrison was paying withholding taxes and complying with the October Plan, rendered his conduct non-willful, and, thus, not in violation of section 6672.

Moreover, the plaintiff contends that even if he is found liable, the amount of his liability should be reduced for three reasons. First, after Koba filed for bankruptcy, the IRS asserted a claim in the amount of $1,135,143, secured by real estate, a motor vehicle, and other collateral. Johnson argues that if the present action against him is successful, and if the claim ***421** against Koba's bankruptcy estate is valid, Johnson's personal liability under section 6672 must be reduced accordingly. Second, Johnson argues that the United States failed to pay Koba $100,000 owed under various government contracts. According to Johnson, the government withheld these funds, at least in part, because of the tax liability that the IRS now seeks to collect from Johnson. Finally, Johnson argues that, after Koba filed for Chapter 11 bankruptcy, and subsequently converted that claim to Chapter 7 bankruptcy, the bankruptcy trustee had the statutory obligation "to collect and reduce to money the property of the estate for which the trustee serves," 11 U.S.C. § 704(1) (2001), and then to make a distribution of those funds to creditors. *Id.* § 726. Johnson points out that the IRS has priority in such proceedings for its claims to withholding taxes. *See* 11 U.S.C. § 507(a)(8)(C) (2001). Therefore, Johnson argues that the amount of his liability must be reduced by the amount that the IRS receives from the bankruptcy trustee for Koba's liability.

This case is before the Court on the United States' motion for summary judgment, to which the plaintiff has filed an opposition. The United States has filed a reply, and no oral hearing is necessary. Local Rule 105.6 (D.Md.). For the reasons set forth in the opinion below, this Court, by separate Order, will GRANT the Defendant's Motion for Summary Judgment.

II. *DISCUSSION*

A. *Standard for Summary Judgment*

The moving party has the initial responsibility of informing the Court of the basis for the belief that summary judgment is warranted. *See* Fed.R.Civ.P. 56; *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986); *Pulliam Inv. Co. v. Cameo Props.*, 810 F.2d 1282, 1286 (4th Cir.1987). Once a motion for summary judgment is made and supported, the nonmoving party "may not rest upon the mere allegations or denials of [that] party's pleading, but ... must set forth specific facts showing that there is a genuine issue for trial." Fed.R.Civ.P. 56(e); *see also Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). The Court will grant summary judgment if there is "no genuine issue as to any material fact." Fed.R.Civ.P. 56(c). A fact is material only if, when applied to the substantive law, the fact affects the outcome of the suit. *Liberty Lobby*, 477 U.S. at 248, 106 S.Ct. 2505. While the Court may not weigh the evidence, it must determine whether there is a genuine issue for trial. As the Supreme Court stated in *Anderson*, "[t]he mere existence of a scintilla of evidence in support of the [nonmoving party's] position will be insufficient; there must be evidence on which the jury could reasonably find for the [nonmoving party]." *Id.* at 252, 106 S.Ct. 2505.

B. *An Employer's Liability Under Section 6672*

Under 26 U.S.C. §§ 3102 & 3402 (2001), an employer is required to withhold federal income and social security taxes from the wages paid to its employees. These funds are held in trust for the United States, and the employer is required to report the amount on its quarterly payroll tax return. 26 U.S.C. § 7501 (2001); Treasury Regulations on Employment Taxes § 31.6011(a)-4(a)(1). It is important to note, however, that the employer is liable for the taxes from the moment the wages are paid. *See, e.g., Thomsen v. United States,* 887 F.2d 12, 14 (1st Cir.1989). "The 'trust fund taxes' are for the exclusive use of the Government and are not to be used to pay the employer's business expenses, including salaries, or for ***422** any other purpose." *Gephart v. United States,* 818 F.2d 469, 472 (6th Cir.1987).

In addition to a corporate employer's liability, its officers and agents who are responsible for collecting and paying the withheld taxes may incur personal liability for unpaid payroll taxes. 26 U.S.C. § 6672 (2001). Section 6672 provides, in pertinent part:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

Id. § 6672(a).

Only certain parties can be held personally liable, though, and then only for certain conduct: "(1) the party assessed must be a person required to collect, truthfully account for and pay over the tax, referred to as a 'responsible person'; and (2) the responsible person must have willfully failed to insure that the withholding taxes were paid." *O'Connor v. United States,* 956 F.2d 48, 50 (4th Cir.1992) (citing *United States v. Pomponio,* 635 F.2d 293 (4th Cir.1980)).

1. "*Responsible Person*"

The primary inquiry in determining whether a party is a "responsible person" under section 6672 is whether the party "so 'participate[d] in decisions concerning payment of creditors and disbursement of funds' that he effectively had the authority -- and hence a duty -- to ensure payment of the corporation's payroll taxes." *Plett v. United States,* 185 F.3d 216, 219 (4th Cir.1999) (quoting *O'Connor,* 956 F.2d at 51). "Stated differently, the 'crucial inquiry is whether the person had the 'effective power' to pay the taxes--that is, whether he had the actual authority or ability, in view of his status within the corporation, to pay the taxes owed.' " *Id.* (quoting *Barnett v. Internal Revenue Serv.,* 988 F.2d 1449, 1454 (5th Cir.1993)). Such authority "is generally found in high corporate officials charged with general control over corporate business affairs who participate in decisions concerning payment of creditors and disbursement of funds." *O'Connor,* 956 F.2d at 51 (citing *Monday v. United States,* 421 F.2d 1210 (7th Cir.1970)). Other factors considered in making this determination include whether the party:

> (1) served as an officer of the company or as a member of its board of directors; (2) controlled the company's payroll; (3) determined which creditors to pay and when to pay them; (4) participated in the day-to-day management of the corporation; (5) possessed the power to write checks; and (6) had the ability to hire and fire employees.

Plett, 185 F.3d at 219 (citing *O'Connor*, 956 F.2d at 51; *United States v. Landau*, 155 F.3d 93, 100-01 (2d Cir.1998); *Barnett*, 988 F.2d at 1455).

[1] It is clear that the plaintiff was a "responsible person" under section 6672. He had decisionmaking authority over the finances of the corporation. He was Koba's president, chairman of the board of directors, and majority shareholder. He was actively involved in the day-to-day management of the corporation, meeting with his vice presidents weekly and hiring and firing key employees. He also enjoyed, and indeed exercised, the ability to determine which creditors were paid and at what time, and he had signature authority over the corporate checking account. Moreover, Johnson personally negotiated ***423** with the IRS and submitted payment plans on behalf of the corporation. He also personally supervised, or directed others to supervise, Morrison's compliance with these payment plans.

[2] The mere fact that Johnson hired Morrison to lead the finance department does not relieve him of the "responsible person" designation. More than one person within a corporation can be a "responsible person" under section 6672, *O'Connor*, 956 F.2d at 50, and it is a "well established and fundamental principle that a person cannot avoid the duty to assure that withholding taxes are paid to the government simply by delegating the responsibility to

pay those taxes to a subordinate." *Szego v. Internal Revenue Serv.*, 1994 WL 408191 (D.Md.) (citing *Purcell v. United States*, 1 F.3d 932, 937 (9th Cir.1993); *Barnett*, 988 F.2d at 1454; *George v. United States*, 819 F.2d 1008, 1012 (11th Cir.1987)).

The plaintiff maintained supervisory control over Morrison and had the power at all times to fire him or personally ensure that the corporation pay the debts owed. Even if Johnson delegated some or all of his financial responsibilities, "[d]elegation of the actual preparation of tax returns, the keeping of records, the payment of wages and the withholding of taxes does not reduce an otherwise responsible person to the status of one not responsible." *Peek v. United States*, 1991 WL 82842 at *4 (D.Md.) (quoting *Thomsen*, 887 F.2d at 17, in turn quoting *Grover v. United States*, 691 F.Supp. 1572, 1576 (D.Mass.1988)).

2. *Willful Failure to Pay*

[3] In failing to pay withholding taxes, a responsible person's conduct is "willful" if he had "knowledge of nonpayment or reckless disregard of whether the payments were being made." *Turpin v. United States*, 970 F.2d 1344, 1347 (4th Cir.1992); *see also Plett*, 185 F.3d at 219. "The 'intentional preference of other creditors' over the United States is 'sufficient to establish the element of willfulness' under section 6672(a)." *Turpin*, 970 F.2d at 1347. (quoting *Pomponio*, 635 F.2d at 298 n. 5). "The responsible person must know of or recklessly disregard the existence of an unpaid deficiency ... for there to be an intentional preference." *Id.*

The plaintiff is an extremely well educated businessman, who built and maintained a productive business for over twenty-six years. He negotiated his company through delinquency problems with the IRS on a number of occasions, and he admittedly knew of the

importance of honoring the obligation to pay withholding taxes. Johnson had, at times, primary responsibility for Koba's finances, and he knew of his company's tendency to fall behind on payroll taxes, and that Morrison would have to manage this recurring problem. He took steps to supervise Morrison, met with him regularly to discuss Koba's financial affairs, and was provided with several accountings of checks written on behalf of the corporation.

Each of these above-described circumstances existed during each of the three quarters at issue in this case. It is clear from these circumstances generally--and the occurrences of each quarter in particular--that Johnson acted with reckless disregard of whether Koba was honoring its tax obligations. *See Turpin*, 970 F.2d at 1347. Therefore, the Government is entitled to judgment as a matter of law as to the "willfulness" element of section 6672.

a. *The Third Quarter of 1994*

During the third quarter of 1994, Johnson supervised and trained Morrison as vice president of finance. Morrison continually provided Johnson with documents that listed checks that he had written on ***424** behalf of the corporation, and Johnson met with Morrison and other vice presidents every week. Although Morrison never mentioned the company's tax problems in these meetings or reports, Johnson made little effort to ensure that his new vice president was managing Koba's often-problematic payroll taxes. After Johnson discovered in October that taxes from the prior quarter had not been paid, Koba continued to pay creditors other than the United States. Upon learning of the deficiency, Johnson assumed primary responsibility by personally negotiating a payment plan with the IRS.

Johnson, however, failed to ensure that his company followed the plan: he instructed Morrison to abide by the

negotiated terms and monitored the payments for a short period of time, but he soon withdrew his supervision and turned the plan over to Morrison, who, Johnson believed, had caused the deficiency in the first place. Moreover, Johnson signed Koba's corporate tax return for the third quarter, which on its face indicated the extent to which Koba was delinquent for the third quarter's payroll taxes. While he might not have known whether Morrison was making the payments, his failure to inform himself, alongside his failure to exercise his authority as president and chairman of the board to ensure that the IRS was satisfied, amounts to a reckless failure to pay withholding taxes akin to willful blindness.

b. *The Fourth Quarter of 1994*

Johnson discovered that Koba was severely delinquent in withholding taxes in October, during the fourth quarter of 1994. After finding out about the deficiency and personally arranging a payment plan with the IRS, Johnson contends that he left the entire business of making the payments to Morrison. Johnson was reckless, at best, in his monitoring of Morrison, and, despite his knowledge of the continuing existence of the problem, at no time did Johnson: (1) request documentation that indicated that Morrison was paying the taxes; (2) contact the IRS to ensure that it was satisfied with Koba's compliance with the plan; (3) fire and replace Morrison for having neglected to pay the taxes in the first place; or (4) simply write checks on Koba's behalf to ensure compliance with the plan.

Moreover, Johnson reviewed and signed Koba's corporate tax return for the fourth quarter, which indicated on its face the growing amount of Koba's unpaid withholding taxes. Again, Johnson's failure to follow up on the plan that he had arranged with the IRS, and his

continued ignorance of Morrison's activities, amounted to a reckless disregard for the existence of the unpaid deficiency.

c. *The First Quarter of 1995*

Finally, by the first quarter of 1995, Johnson was undoubtedly aware of Koba's growing problem with the IRS. In January 1995, Johnson learned of the IRS's intent to levy, and, again, personally negotiated a plan with the IRS to keep Koba afloat. Knowing by now of Morrison's complete inability to follow the terms of the October Plan, Johnson appointed Robinson, the company's in-house counsel, to supervise Morrison's compliance with this new plan. Again, however, Johnson did not adequately supervise Morrison or personally ensure that the plan was followed. Johnson chose not to exercise his power as president and chairman of the board to fire Morrison or otherwise to actively ensure that Koba's taxes were paid. He chose instead to leave the resolution of the problem in the hands of two of his subordinates, one of whom was demonstrably unreliable. Moreover, as in the two prior quarters, Johnson again reviewed and signed Koba's corporate tax return for the first quarter ***425** of 1995, which clearly indicated a growing, unpaid tax deficiency.

It is clear from the evidence that Morrison's incompetence was a direct cause of Koba's continued failure to remit withholding taxes. It is equally clear, however, that Johnson knew of and recklessly disregarded the existence of the unpaid deficiency. In opposition to summary judgment, the plaintiff attempts to create a genuine dispute of material fact by contending that he did not know whether Morrison was paying the tax deficiency. Even assuming that he lacked actual knowledge of Morrison's conduct, there is no question that Johnson's continued failure to take action on Koba's behalf exceeded the bounds of mere negligence and crossed over the line into the territory of willfulness.

Johnson had actual knowledge of Koba's tax problems, and he directly involved himself in solving those problems by personally arranging two payment plans with the IRS. Johnson then attempted to delegate the duty to comply with the plans to the very man who had caused the deficiency and failed to supervise him adequately under both plans. As an experienced businessman with knowledge of Koba's history of deficient taxes and the seriousness of honoring tax obligations, Johnson was, as a matter of law, willful in his failure to pay withholding taxes under section 6672.

C. *The IRS's Right to Single Recovery Under Section 6672*

[4] Finally, the plaintiff claims that, if he were found liable under section 6672, there would be a triable issue as to the amount owed to the IRS. The plaintiff argues that the IRS has priority in Koba's bankruptcy proceedings and has asserted a secured claim in the amount of $1,135,143. Therefore, the plaintiff argues, a factual issue exists as to how much Johnson would owe if found liable.

This is not a factual issue that will prevent summary judgment; the amount of withholding taxes owed to the IRS is not in dispute. All that Johnson seems to contest is whether the IRS can attempt to collect those taxes from Koba's bankruptcy estate as well as from him personally. As the Fourth Circuit recognized in *Pomponio*, 635 F.2d at 298 (quoting *Kelly v. Lethert*, 362 F.2d 629, 635 (8th Cir.1966)), "[t]he result of Section 6672 is thus to make the responsible officers of the corporation, as well as the corporation itself, equally liable as co-debtors to the Government, and the Government may proceed against either in the order best suited in its judgment to collect the unpaid tax." So, it is clear that the IRS may attempt to satisfy Koba's debt through actions against Johnson or Koba.

The plaintiff also intimates concern that the IRS might attempt to obtain some sort of double recovery from both Koba and Johnson in excess of the established amount of withholding taxes due. This was a concern addressed in *Pomponio, supra,* as well. In that case, the Fourth Circuit allayed the fears of double recovery by acknowledging the IRS's established administrative policy to collect the total penalty under section 6672 only once. *See id.* at 298 n. 6 (citing *United States v. Sotelo,* 436 U.S. 268, 279-80 n. 12, 98 S.Ct. 1795, 56 L.Ed.2d 275 (1978)). The court also explained that, even absent the internal IRS policy, the agency was not entitled to double recovery under section 6672. *Id.* at 298-99, 98 S.Ct. 1795 (quoting *Brown v. United States,* 591 F.2d 1136, 1142-43 (5th Cir.1979) (citing *Kelly v. Lethert,* 362 F.2d 629, 635 (8th Cir.1966); *Newsome v. United States,* 431 F.2d 742, 745 (5th Cir.1970))). Finally, the *Pomponio* court explained that any lingering concerns of double recovery could easily be extinguished by a carefully drafted judgment order of the district court. *Id.* at 299. In the case now before the Court, the mere fact that ***426** the IRS is attempting to secure a second source for the payment of taxes owed does not necessarily mean that it will attempt to exhaust both sources in excess of the debt. If it attempts to do so in the future, not only will it be in violation of its own policies and the law of the Fourth Circuit, but it also will find itself in direct violation of the separate Order that this Court will issue pursuant to this Opinion.

Judgment in this case entitles the IRS to recovery of the full amount of Koba's withholding taxes. To the extent that the IRS collects on the fixed debt of $887,726.78 (plus interest and statutory penalties accumulated to this date) pursuant to Koba's bankruptcy proceedings, the amount owed under this judgment will be reduced. If the IRS collects beyond this amount, which an upcoming Order will prohibit, Johnson is free to file a separate action for injunctive relief. With the goal of preventing further

conflict, the upcoming Order will obligate the IRS to report to this Court every 180 days concerning the status of its collection efforts against Koba in bankruptcy and against the plaintiff personally.

As the original debt of $887,726.78 is now undoubtedly different due to penalties and interest, it would be helpful if counsel could confer and agree upon a liquidated amount that includes such penalties and interest as of a date certain--January 22, 2002. Responses should be faxed to the chambers of the Court (410-962-2686) as soon as possible, but not later than noon on January 22. Upon receiving an agreed upon amount, the Court will issue an Order pursuant to the terms of this Opinion, GRANTING the Defendant's Motion for Summary Judgment and CLOSING this case.

203 F. Supp.2d 416, 89 A.F.T.R.2d 2002-1000, 2002-1 USTC P 50,267

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 02-1240
CA-98-3050-S

FORD T. JOHNSON, JR.
Plaintiff - Appellant

v.

UNITED STATES OF AMERICA
Defendant - Appellee

Entered: January 28, 2003

On Petition for Rehearing En Banc

The appellant's petition for rehearing en banc was submitted to this Court. As no member of this Court requested a poll on the petition for rehearing en banc,

IT IS ORDERED that the petition for rehearing en banc is denied.

For the Court,
/s/Patricia S. Connor
Clerk

26 U.S.C. § 3102(a) (2001) provides:

Requirement.--The tax imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. An employer who in any calendar year pays to an employee cash remuneration to which paragraph (7)(B) of section 3121(a) is applicable may deduct an amount equivalent to such tax from any such payment of remuneration, even though at the time of payment the total amount of such remuneration paid to the employee by the employer in the calendar year is less than the applicable dollar threshold (as defined in section 3121(x)) for such year; and an employer who in any calendar year pays to an employee cash remuneration to which paragraph (7)(C) or (10) of section 3121(a) is applicable may deduct an amount equivalent to such tax from any such payment of remuneration, even though at the time of payment the total amount of such remuneration paid to the employee by the employer in the calendar year is less than $100; and an employer who in any calendar year pays to an employee cash remuneration to which paragraph (8)(B) of section 3121(a) is applicable may deduct an amount equivalent to such tax from any such payment of remuneration, even though at the time of payment the total amount of such remuneration paid to the employee by the employer in the calendar year is less than $150 and the employee has not performed agricultural labor for the employer on 20 days or more in the calendar year for cash remuneration computed on a time basis; and an employer who is furnished by an employee a written statement of tips (received in a calendar month) pursuant to section 6053(a) to which paragraph (12)(B) of section 3121(a) is applicable may deduct an amount equivalent to such tax with respect to such tips from any wages of the employee (exclusive of tips) under his control, even though at the time such statement is furnished the total amount of the tips included in statements furnished to the employer as having

been received by the employee in such calendar month in the course of his employment by such employer is less than $20.

26 U.S.C. § 3402(a) (2001) provides:

Requirement of withholding.--

> (1) In general.--Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Any tables or procedures prescribed under this paragraph shall--
>
> > (A) apply with respect to the amount of wages paid during such periods as the Secretary may prescribe, and
> >
> > (B) be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of this chapter and to reflect the provisions of chapter 1 applicable to such periods.
>
> (2) Amount of wages.--For purposes of applying tables or procedures prescribed under paragraph (1), the term "the amount of wages" means the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption. The amount of each withholding exemption shall be equal

to the amount of one personal exemption provided in section 151(b), prorated to the payroll period. The maximum number of withholding exemptions permitted shall be calculated in accordance with regulations prescribed by the Secretary under this section, taking into account any reduction in withholding to which an employee is entitled under this section.

26 U.S.C. § 6672(a) (2001) provides:

General rule.--Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 or part II of subchapter A of chapter 68 for any offense to which this section is applicable.

26 U.S.C. § 7501(a) (2001) provides:

General rule.--Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

28 U.S.C. § 1254 (2001) provides:

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

> (1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;
>
> (2) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

28 U.S.C. § 1291 (2001) provides:

The courts of appeals (other than the United States Court of Appeals for the Federal Circuit) shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court. The jurisdiction of the United States Court of Appeals for the Federal Circuit shall be limited to the jurisdiction described in sections 1292(c) and (d) and 1295 of this title.

28 U.S.C. § 1346(a) (2001) provides:

The district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims, of:

(1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws;

(2) Any other civil action or claim against the United States, not exceeding $10,000 in amount, founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort, except that the district courts shall not have jurisdiction of any civil action or claim against the United States founded upon any express or implied contract with the United States or for liquidated or unliquidated damages in cases not sounding in tort which are subject to sections 8(g)(1) and 10(a)(1) of the Contract Disputes Act of 1978. For the purpose of this paragraph, an express or implied contract with the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges, or Exchange Councils of the National Aeronautics and Space Administration shall be considered an express or implied contract with the United States.

28 U.S.C. § 2402 (2001) provides:

Subject to chapter 179 of this title, any action against the United States under section 1346 shall be tried by the court without a jury, except that any action against the United States under section 1346(a)(1) shall, at the request of either party to such action, be tried by the court with a jury.

Supreme Court, U.S.
FILED
JUN 12 2003
OFFICE OF THE CLERK

No. 02-1581

In the Supreme Court of the United States

FORD T. JOHNSON, JR., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner "willfully" failed to pay over to the United States the payroll taxes withheld by his company from the wages of its employees and is therefore personally liable for the amount of those taxes under Section 6672 of the Internal Revenue Code, 26 U.S.C. 6672.

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In the Supreme Court of the United States

No. 02-1581

FORD T. JOHNSON, JR., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-2) is not published in the *Federal Reporter* but is *reprinted in* 50 Fed. Appx. 113. The opinion of the district court (Pet. App. 5-25) is reported at 203 F. Supp. 2d 416.

JURISDICTION

The judgment of the court of appeals was entered on November 6, 2002. The petition for rehearing was denied on January 28, 2003. Pet. App. 26. The petition for a writ of certiorari was filed on April 28, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner was the president, chairman of the board, founder and majority shareholder of a consulting company named Koba Associates, Inc. In those capacities, he was actively involved in the day-to-day management of the company and made all major decisions for it. In particular, he hired and supervised key employees and exercised control over the company's financial affairs. He had check signing authority on the company's bank account and routinely determined which creditors would be paid and how much to pay them. Pet. App. 8.

Throughout the period prior to and including 1994, petitioner's company experienced ongoing financial difficulties. The company was frequently delinquent in paying over to the government the taxes that it withheld from its employees' wages. Pet. App. 9. Petitioner testified, however, that, until these problems became severe during 1994, he "was always able to juggle it." *Ibid.* During 1994, as the company's financial situation worsened, petitioner hired Laurence Morrison as director of finance. *Ibid.* After hiring him, petitioner closely supervised Morrison and instructed him concerning his strategy for juggling payments among creditors and withholding taxes. *Id.* at 10. During the third quarter of 1994, petitioner promoted Morrison to vice president and met with Morrison weekly concerning financial matters. At those meetings, Morrison provided petitioner with lists of the company's accounts payable and with an accounting of the checks that had been written on the corporate accounts. *Ibid.*

2. In October 1994, petitioner reviewed and signed the company's quarterly tax return for the third

quarter of 1994. That return indicated that the company had unpaid withholding taxes due in the amount of $415,853.82 and that no payments had been made by the company for that quarter. Pet. App. 10. In that same month, petitioner was notified by the Internal Revenue Service (IRS) that the company was delinquent on its withholding taxes for the third quarter of 1994. After receiving that notice, petitioner contacted the IRS and agreed to a payment plan to satisfy the outstanding liability. Petitioner supervised his company's compliance with the payment plan at first but thereafter left Morrison in charge of financial matters. *Id.* at 11. Although Morrison regularly provided financial reports to petitioner during this period, those reports did not describe the status of the company's withholding tax obligations. *Id.* at 12.

3. The company continued to fail to pay employee withholding taxes during the fourth quarter of 1994 and stopped complying with the payment plan for the prior delinquencies. In December 1994, the IRS sent a notice of intent to levy to collect the unpaid taxes from the company. Pet. App. 12. Petitioner reviewed and signed the quarterly tax return for the fourth quarter of 1994, which indicated that the company had unpaid payroll taxes of $324,655.65. *Ibid.*

After receiving the notice of intent to levy, petitioner again briefly became involved in the company's employment tax situation. Petitioner again contacted the IRS and agreed to a second payment plan. Petitioner assigned Sandra Robinson, an in-house lawyer for the company, to supervise compliance with the second plan. Pet. App. 12. The company nonetheless again failed to comply with the new plan and did not meet its tax obligations for the first quarter of 1995. Petitioner reviewed and signed the tax return for the first quarter

of 1995, which clearly set forth the growing amount of the company's unpaid withholding tax liability. *Id.* at 12-13. Notwithstanding the substantial unpaid liability to the United States that existed throughout this period, the company continued to pay creditors other than the United States by "juggl[ing]" the funds obtained through the withheld taxes. *Id.* at 9, 13.

3. Under Section 6672(a) of the Internal Revenue Code, 26 U.S.C. 6672(a), a person who is responsible for paying over taxes withheld from employee wages but who "willfully" fails to do so is personally liable for the amount of taxes not paid over. Petitioner was assessed under this statute for the third and fourth quarters of 1994 and the first quarter of 1995. Pet. App. 7. When an overpayment of his personal income taxes was applied against this liability, petitioner filed suit in district court for a refund. The government counterclaimed for the balance of the unpaid assessment.

The district court granted summary judgment to the government. Pet. App. 5. The court held that petitioner had complete decision-making authority for the company and was therefore "responsible" as a matter of law for collecting and paying over the taxes withheld from the wages of the company's employees. *Id.* at 18-19. The court then further concluded, on the basis of the undisputed facts, that petitioner had acted "willfully" in failing to pay over those taxes and was therefore personally liable for the taxes under Section 6672(a). *Id.* at 19-20.

The court noted that petitioner was "an extremely well educated businessman," that he had "negotiated his company through delinquency problems with the IRS on a number of occasions," and that he "admittedly knew of the importance of honoring the obligation to pay withholding taxes." Pet. App. 19-20. The court

further noted that petitioner "knew of his company's tendency to fall behind on payroll taxes" and had selected Morrison "to manage this recurring problem." *Id.* at 20. After hiring Morrison in 1994, however, petitioner "made little effort to ensure that his new vice president was managing Koba's often-problematic payroll taxes." *Ibid.* In particular, although petitioner knew of the withholding tax delinquencies and had negotiated a payment plan with the IRS, petitioner failed to ensure that the plan was followed. *Ibid.* Instead, petitioner "withdrew his supervision and turned the plan over to Morrison, who, [petitioner] believed, had caused the deficiency in the first place." *Id.* at 21. Moreover, by the fourth quarter of 1994, although petitioner had actual knowledge that the company was "severely delinquent" in paying over its withheld payroll taxes, "at no time did [petitioner]: (1) request documentation that indicated that Morrison was paying the taxes; (2) contact the IRS to ensure that it was satisfied with Koba's compliance with the plan; (3) fire and replace Morrison for having neglected to pay the taxes in the first place; or (4) simply write checks on Koba's behalf to ensure compliance with the plan." *Ibid.* And, this same situation continued in the first quarter of 1995. *Id.* at 22. The court concluded that (*id.* at 23):

> [Petitioner] had actual knowledge of Koba's tax problems, and he directly involved himself in solving those problems by personally arranging two payment plans with the IRS. [Petitioner] then attempted to delegate the duty to comply with the plans to the very man who had caused the deficiency and failed to supervise him adequately under both plans. As an experienced businessman with knowl-

> edge of Koba's history of deficient taxes and the seriousness of honoring tax obligations, [petitioner] was, as a matter of law, willful in his failure to pay withholding taxes under section 6672.

4. In a brief *per curiam* opinion, the court of appeals affirmed "on the reasoning of the district court." Pet. App. 2. The court held that "[t]he evidence before the district court established that [petitioner] 'willfully' failed to pay over the payroll taxes at issue, within the meaning of § 6672." *Ibid.*

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. a. Sections 3102(a) and 3402(a) of the Internal Revenue Code require employers to withhold taxes from the wages of their employees and to remit the amounts withheld to the government. 26 U.S.C. 3102(a), 3402(a). The taxes withheld by an employer from employee wages constitute a special trust fund for the benefit of the United States. 26 U.S.C. 7501; see *Begier* v. *IRS*, 496 U.S. 53, 60 (1990). A person who is responsible for collecting, accounting for, or paying over such trust fund withholding taxes—and who "willfully" fails to do so—is personally liable for the amount of those taxes under Section 6672(a) of the Code, 26 U.S.C. 6672(a). See *Slodov* v. *United States*, 436 U.S. 238, 242-245 (1978).

In the present case, there was no genuine dispute that petitioner was a "responsible person," who had the duty and authority to pay over his company's withholding taxes. The issue addressed by the parties was

whether petitioner's failure to pay over the withheld taxes to the government was "willful."

Willfulness under Section 6672 does not require an evil motive or an intent to deprive the government of revenue. See *e.g.*, *United States* v. *Rem*, 38 F.3d 634, 643 (2d Cir. 1994); *Kalb* v. *United States*, 505 F.2d 506, 511 (2d Cir. 1974), cert. denied, 421 U.S. 979 (1975). "A responsible person's intentional preference of other creditors over the United States establishes the element of willfulness under § 6672(a)." *Plett* v. *United States*, 185 F.3d 216, 219 (4th Cir. 1999); see *Phillips* v. *United States*, 73 F.3d 939, 942-943 (9th Cir. 1996). The failure of a person responsible for paying over trust fund taxes to the government is "willful" if he had actual knowledge that the taxes were not being paid or acted in reckless disregard of whether the payments were being made. *Plett* v. *United States*, 185 F.3d at 219; *United States* v. *Kim*, 111 F.3d 1351, 1357 (7th Cir. 1997). If the responsible person knew, or should have known, that trust fund taxes were not being remitted, but nevertheless acquiesced in preferring other creditors to the government, "willfulness" is established as a matter of law. *Plett* v. *United States*, 185 F.3d at 223; *Keller* v. *United States*, 46 F.3d 851, 855 (8th Cir.), cert. denied, 516 U.S. 824 (1995); *Jenson* v. *United States*, 23 F.3d 1393, 1395 (8th Cir. 1994); *Purcell* v. *United States*, 1 F.3d 932, 938 (9th Cir. 1993).

b. The courts below correctly held (Pet. App. 2, 23) that the evidence in this case established, as a matter of law, that petitioner acted "willfully" in failing to remit the withheld taxes to the government. In particular, the record conclusively established that petitioner was well aware that withheld taxes were being used to pay other creditors of the company and were not being paid over to the government. *Id.* at 9, 13.

For each period at issue, petitioner reviewed the company's tax returns, which plainly showed that withheld taxes had not been paid over to the government. Pet. App. 10, 12-13. Petitioner received regular accountings of checks written on behalf of the company, which also showed that taxes were not being paid over to the government. *Id.* at 20. Indeed, petitioner now acknowledges (Pet. 3) that he had actual knowledge that the withheld taxes were not being paid over to the government.

The record also clearly established that petitioner knew that amounts owed to other creditors were being paid during the same periods that the withheld taxes were not being paid to the government. Pet. App. 10, 13. This knowing use of trust fund withheld taxes to pay other creditors establishes that petitioner acted "willfully" as a matter of law. *E.g.*, *Plett* v. *United States*, 185 F.3d at 223; *Keller* v. *United States*, 46 F.3d at 855.

2. Petitioner argues that a conflict exists among the circuits because the Tenth Circuit has held that "reasonable cause" may justify an exception to liability that other courts have held exists under Section 6672 as a matter of law. Pet. 6-7 (citing *Finley* v. *United States*, 123 F.3d 1342, 1348 (10th Cir. 1997)). Since there is no plausible basis for petitioner to urge that he had "reasonable cause" for failing to pay over the withheld taxes, and since neither the district court nor the court of appeals addressed any such claim in this case, the decision below cannot be said to conflict with the reasoning or result in *Finley*.

Even if a "reasonable cause" exception to liability exists under Section 6672, it is clear that "reasonable cause" did not exist in this case. The courts that have described a "reasonable cause" exception to liability

under Section 6672 have emphasized that its application would necessarily be "exceedingly limited."[1] *Logal* v. *United States*, 195 F.3d 229, 233 (5th Cir. 1999). For example, in *Finley*, the Tenth Circuit stated that "reasonable cause sufficient to excuse a responsible person's failure to pay withholding taxes should be limited to those circumstances where (1) the taxpayer has made reasonable efforts to protect the trust funds, but (2) those efforts have been frustrated by circumstances outside the taxpayer's control." 123 F.3d at 1348. See also *Howell* v. *United States*, 164 F.3d 523, 526 (10th Cir. 1998) (same).[2]

In the present case, it is undisputed that petitioner had complete control over the finances of his company and could have taken action to see that the taxes were paid with available funds. Pet. App. 8. Even though he had actual knowledge that the withheld taxes were being misused to pay other creditors, petitioner did not take the ordinary step of simply writing a check to the government to pay the withheld taxes when due. *Id.* at

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[1] The First, Seventh, Eighth, and Ninth Circuits have declined to recognize a "reasonable cause" exception. *Olsen* v. *United States*, 952 F.2d 236, 241 (8th Cir. 1991); *Harrington* v. *United States*, 504 F.2d 1306, 1316 (1st Cir. 1974); *Pacific Nat'l Ins. Co.* v. *United States*, 422 F.2d 26, 33 & n.19 (9th Cir.), cert. denied, 398 U.S. 937 (1970); *Monday* v. *United States*, 421 F.2d 1210, 1216 (7th Cir.), cert. denied, 400 U.S. 821 (1970).

[2] In *Winter* v. *United States*, 196 F.3d 339 (2d Cir. 1999), the court of appeals merged the "willfulness" and "reasonable cause" inquiries by describing a "reasonable cause" exception from liability that exists when the responsible person held a "reasonable" belief that the taxes had in fact been properly paid over to the government. *Id.* at 345. In the present case, there is no dispute that petitioner had actual knowledge that the withheld taxes had not been paid over; petitioner thus plainly lacked any "reasonable" belief that the taxes had been paid.

21. Instead, he allowed other creditors to be paid with the trust funds withheld from employees' wages for the benefit of the United States. *Id.* at 13.

On this record, petitioner plainly did not make reasonable efforts to protect the trust fund taxes.[3] Even if a "reasonable cause" exception to liability exists, "[n]o such defense may be asserted by a responsible person who knew that the withholding taxes were due, but who made a conscious decision to use corporate funds to pay creditors other than the government." *Logal* v. *United States*, 195 F.3d at 232-233. Accord, *Thosteson* v. *United States*, 304 F.3d 1312, 1318-1320 (11th Cir. 2002). See also *Winter* v. *United States*, 196 F.3d at 345-346 (even if a "reasonable cause" exception to liability exists, and "even if a responsible person did not know contemporaneously of the company's nonpayment of withholding taxes, he or she will be held liable for any nonpayment if, when he or she became aware of the delinquency, the company had liquid assets with which to pay the overdue taxes").

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[3] This case is thus obviously distinguishable from *Finley*, 123 F.3d at 1344, where the responsible person delivered funds to his bank and directed that they be applied to withholding taxes, but the bank refused to do so. It is also distinguishable from *Howell*, 164 F.3d at 526-527, where the company set aside money to ensure that trust fund taxes were paid but its underwriters seized control of company and improperly used its accounts to pay other creditors.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE
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FORD T. JOHNSON, JR.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

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In response to the Brief for the United States in Opposition ("Brief in Opposition"), Petitioner Ford T. Johnson, Jr. ("Johnson") takes exception on two grounds to the arguments of the United States ("Government"). First, the Government has mischaracterized the facts of this case through a conveniently selective and misleading presentation. Second, the facts of this case are not sufficient to preclude Johnson from establishing reasonable cause that would vitiate any inference of willfulness that might arise from the Government's evidence at bar.

1. Mischaracterization of Facts By the Government

The Government's presentation of the instant case as one in which Johnson made a "conscious decision" to pay creditors instead of the Internal Revenue Service ("IRS") is a distortion of the record. The Government argues that Johnson's "company was frequently delinquent in paying over to the government the taxes that it withheld from its employees' wages." Brief in Opposition at 2. As reflected in the page included in the Appendix hereto from the Government's reply memorandum in the District Court below, the Government acknowledged that it did not know of any delinquencies by the company prior to the three quarters at issue in the instant case.

In its Brief in Opposition, the Government does not contend that Johnson ever wrote a single check to any creditor during the period in which the Government contends that he acted willfully, and thus the instant case is distinguishable from that of *Plett v. United States*, 185 F.3d 216 (4th Cir. 1999), in which the corporate officer who was liable for withholding taxes did write checks. Instead the objective facts in this case reflect a situation in which Johnson delegated responsibility to the chief financial officer of the company, Laurence Morrison ("Morrison"), for payment of all the company's obligations, including that of tax payment. There is not a shred of evidence that Johnson directed Morrison not to make withholding tax payments to

the IRS. Indeed when Johnson learned that Morrison had not made the required tax payments, he took a number of steps to correct the situation. At first he supervised this individual directly, then he had the company's legal counsel do so. He also negotiated payment plans with the IRS to resolve the situation.

The Government's contention is not that Johnson did nothing to supervise this individual but that he did not do enough. In no context other than that of 26 U.S.C. § 6672(a) (2001) would anyone ever conclude that this factual situation - of at most arguably deficient supervision - rises to the level of willfullness. *See Smith v. First Union Nat'l Bank*, 202 F.2d 234, 249-50 (4th Cir. 2000) (knowledge of employee's incompetence creates liability for negligent supervision or retention), *Norman v. Southern Guaranty Ins. Co.*, 191 F. Supp. 2d 1321, 1337 (M.D. Ala. 2002) (same). While the desire to insure the payment of taxes is noble, that objective cannot be accomplished by a tortured construction of statutory language to convert at worst negligent conduct into willful conduct. This is precisely why the court in *Finley v. United States*, 123 F.3d 1342 (10th Cir. 1997), construed § 6672(a) as allowing a corporate officer to escape liability under that section through a showing of "reasonable cause".

The actions that the Government repeatedly describes as "juggling" are more appropriately described as cash management by which Johnson insured that his company remained current in its payment of withholding taxes for the twenty five year period during which Johnson's company was in existence prior to the three quarters for which the Government seeks to recover the penalty at issue herein from Johnson. Indeed the Government admits that it cannot identify a single quarter in which Johnson's company was delinquent on withholding taxes prior to the three quarters at bar. It was only when the government refused to pay its debts to Johnson's company that

Johnson's company was unable to pay its debts to the Government.

2. Conflict Between the Circuits as to Whether Actual Intent of a Corporate Officer Determines Willfulness

The Government in its Brief in Opposition now attempts to mask the conflict between the circuits on the question of whether reasonable cause, established through evidence of a corporate officer's actual intent, can preclude a finding of willfulness under § 6672(a). The court in *Finley* was of the opinion that the Government's position, under which willfulness is established on the basis of objective factors without regard to actual intent, was contrary to the plain meaning of the statutory language. In its brief before the Fourth Circuit in this case, the Government argued that *Finley* was wrongly decided and provided reasons in support of that contention. The Government explicitly invited that court to reject the reasonable cause defense and follow the "prior, better reasoned, decisions by the First, Seventh, and Ninth Circuits." The Government's argument that *Finley* was wrongly decided is reflected in the pages included in the Appendix hereto from the Government's brief in the Fourth Circuit in this case.

Accordingly, the Government's argument (Brief in Opposition at 8) that "neither the district court nor the court of appeals addressed any such claim" that Johnson had reasonable cause is false. As reflected in the Government's own filing before the Fourth Circuit, the issue was plainly presented. The court below accepted the Government's argument that they should not follow *Finley*. The Fourth Circuit's improvident election to proceed by

summary decision in a case that presents an inter-circuit conflict does not eliminate the conflict.[1]

The Government's argument now attempts to minimize the conflict between the circuits by arguing that *Finley* would not dictate a different result in the instant case. The Government argues that *Finley* is "obviously distinguishable" from the case at bar because in *Finley* "the responsible person delivered funds to his bank and directed that they be applied to withholding taxes, but the bank refused to do so." Brief in Opposition at 10 n. 3. The Government's argument appears to be that the facts of the case in *Finley* supported a finding of "reasonable cause" in that case.

In fact this was precisely what the court in *Finley* stated that it was *not* deciding. The issue in *Finley* was whether the district court in that case had properly granted judgment as a matter of law in favor of the government following a jury verdict in favor of the corporate officer. The court in *Finley* stated that its decision was not to simply reinstate the jury verdict on the ground that the verdict was supported by substantial evidence. 123 F.3d at 1349. The court instead noted that it was not deciding that "reasonable cause" was present in that case but only that the jury should resolve the issue after having been properly

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[1] The Fourth Circuit's decision to summarily decide this case is in sharp contrast to the Eleventh Circuit's contemporaneous treatment of a case involving application of the reasonable cause defense; the court in that case issued not only an initial published opinion but one on rehearing also. *Thosteson v. United States*, 304 F.2d 1312 (11th Cir. 2002), *aff'd on reh'g*, No. 01-14520, 2003 WL 21254887 (11th Cir. June 3, 2003). In any event, the Fourth Circuit's citation in its summary opinion of the docket number for the District Court's opinion rather than the Federal Supplement citation for that opinion - even though the Federal Supplement citation was included in Johnson's reply brief in the court below - presents the question of the extent to which the judges deciding the case below even read the briefs.

instructed concerning the controlling law on what constitutes willfulness. *Id.*

Similarly Johnson is entitled to have his case decided under the correct legal principles as decided by this Court. This Court must decide whether *Finley* or the decisions of the First, Seventh, Eighth, and Ninth Circuits are better reasoned. It is not surprising that the Government wants to avoid resolution of this conflict because a decision by this Court that *Finley* was properly decided would put in jeopardy the Government's virtually automatic right to summary judgment in cases in which it seeks recovery of the penalty under § 6672(a). The proper disposition of the instant case is not to affirm the Fourth Circuit on the basis of a standard that it did not apply, but rather to remand the case to the Fourth Circuit so that it can apply the governing statute as correctly interpreted. *See Meritor Savings Bank v. Vinson*, 477 U.S. 57, 73 (1986) (case remanded when court of appeals had applied erroneous standard of absolute liability regardless of circumstances), *Adarand Constructors, Inc. v. Pena*, 515 U.S. 200, 237 (1995) (case remanded for court of appeals to apply changed rule announced by Court).

The Government's discussion of the decision in *Finley* does not accurately present the content of that decision. The Government interprets *Finley* as teaching that a decision to allow payment to creditors rather than the IRS precludes any showing of reasonable cause irrespective of what the corporate officer might prove to establish reasonable cause. Brief in Opposition at 9-10. The entire thrust of *Finley* is that a person may still establish reasonable cause in those cases in which the facts would (under the decisions in other circuits) establish wilfulness as a matter of law (and therefore entitle the Government to summary judgment). The court in *Finley* stated that even when the corporate officer knows of a withholding tax delinquency and fails to personally fulfill his duty to ensure

payment of the delinquent taxes, he or she still has "the opportunity to demonstrate to a jury there was reasonable cause sufficient to excuse the failure to pay the withholding taxes". 123 F.3d at 1348. Indeed, the court in *Finley* described the facts in the instant case, which involves "[r]eliance upon the representation of someone in control of company finances that withholding taxes will be paid after learning that such taxes are delinquent, and when it is known that the person making the statements is unreliable and has inadequately performed his financial responsibilities in the past", as a paradigm that some courts have identified as supporting a finding of willfulness as matter of law. 123 F.3d at 1345. While under the Government's position such a showing would be the end of the story, *Finley* instructs that those facts are merely the beginning of the story, and that the corporate officer still has the opportunity to establish reasonable cause notwithstanding such a showing by the Government. Accordingly, the Government's position that the facts at bar preclude any showing of reasonable cause - regardless of Johnson's proof in support of reasonable cause - is simply not consistent with *Finley*.

Johnson, therefore, asks that this Court resolve the conflict between *Finley* and the contrary decisions of other circuits so that his case may be decided under the right construction of the language of § 6672(a). Accordingly, the Court should grant his petition for certiorari.

Respectfully submitted,

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* * * *

C. *Johnson should not be excused for his reckless and willful failure to pay over Koba's trust fund taxes on the grounds of "reasonable cause"*

Johnson contends that his actions "were not willful notwithstanding knowledge of prior unpaid taxes because he acted with reasonable cause." (Br. 16.) As the majority of courts have recognized, however, there is no "reasonable cause" exception to the standard of willfulness. *See e.g.*, *Phillips*, 73 F.3d at 942; *Keller*, 46 F.3d at 855; *Brewery, Inc.*, 33 F.3d at 593; *Olsen v. United Sates*, 952 F.2d 236, 240-241 (8th Cir. 1991); *Sorenson v. United States*, 521 F.2d 325, 328 (9th Cir. 1975); *Harrington v. United States*, 504 F.2d 1306, 1316 (1st Cir. 1974); *Pacific Nat'l Ins. Co. v. United States*, 422 F.2d 26, 33 & n. 19 (9th Cir. 1970); *Monday*, 421 F.2d at 1216; *cf. Logal v. United States*, 195 F.3d 229, 233 (5th Cir. 1999) (recognizing theoretical possibility that reasonable cause could negate willfulness, but indicating that no taxpayer has "carried that pail up the hill"). Under the majority view, an individual who knowingly or recklessly disregards whether trust fund taxes are being paid over to the Government, and who uses the corporation's available funds to pay the claims of creditors, is willful under the plain terms of Section 6672 – he cannot be excused because of his good faith or lack of bad motive. *See Phillips*, 73 F.3d at 942 ("No bad motive need be proved, and conduct motivated by reasonable case, such as meeting the payroll, may be 'willful'."); *Harrington*, 504 F.2d 1316 (same); *Monday*, 421 F.2d at 1216 (same). Although the Tenth Circuit has departed from the majority view and adopted a "reasonable cause" exception, *see Finley v. United States*, 123 F.3d 1342, 1347-1348 (10th Cir. 1997),

and the Second Circuit has recognized an even more limited exception, *see Winter*, 196 F.3d at 345, this Court has not done so. Indeed, the only court in this circuit to address the reasonable cause exception has stated that "the Tenth Circuit's opinion [in *Finley*] contrasts with prior, better reasoned, decisions by the First, Seventh, and Ninth Circuits which rejected a reasonable cause' defense." *Mardousian v. United States*, 98-2 U.S. Tax Cas. (CCH) ¶50,754 (D. Md. 1998).

We maintain that the courts that have recognized a "reasonable cause" exception have failed to give due consideration to the mandate imposed by § 7501 that the withholding taxes be held in trust by the employer. That is, a responsible person must segregate the funds and his failure to do so indicates his willfulness. *See e.g.*, *Smith v. United States*, 894 F.2d 1549, 1554-1555 (11th Cir. 1990). Moreover, we submit that recognition of a reasonable cause defense seriously undermines Section 6672 by shifting the focus from encouraging high-level employees to stay abreast of the company's withholding and payment of employees' taxes, to encouraging them to engage in good faith, but unsuccessful, after-the-fact attempts to pay the delinquent withholding taxes, which leave the Government without the withheld taxes even though the employees from whom the taxes were withheld must be given credit. *See, e.g.*, *Olsen*, 952 F.2d at 241; *Monday*, 421 F.2d at 1217-1218.

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Excerpts from Page 2 of United States of America's Reply Memorandum in Support of Its Motion for Summary Judgment in the United States District Court for the District of Maryland

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Plaintiff's first argument on this point is that his actions for the third quarter of 1994 were not willful because he had no notice of previous delinquent taxes.[1] Previous quarters, however, are not at issue here.

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[1] We do not know the "previous delinquent taxes" to which plaintiff refers. The returns for the two quarters prior to the period at issue show no balance due. (Affidavit of Ford T. Johnson, Jr. ("Johnson Aff."), Exs. A, B.)